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EX PARTE OR LATE FILED

December 2, 1996

RECEIVED
DEC 2 - 1996
Federal Communications Commission
Office of Secretary

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: CC Docket No. 96-98

Dear Mr. Caton:

On Monday, December 2, 1996, the attached letter was sent by courier to each of the FCC Commissioners.

Two (2) copies of this Notice are being filed with the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commissions's Rules.

Sincerely,

Frederick Warren-Boulton

Attachment

cc: Chairman Hundt
Commissioner Chong
Commissioner Ness
Commissioner Quello

No. of Copies rec'd 0+1
List ABCDE

December 2, 1996

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W. - Room 814
Room 814
Washington, DC 20554

Dear Chairman Hundt:

In the wake of the stay recently granted by the Eighth Circuit U.S. Court of Appeals of the pricing provisions of the FCC's order on local interconnection policy, the principles underlying the order have come into question. The commission's decision to require the incumbent local exchanges to offer network elements and interconnection at prices based on total element long run incremental cost (TELRIC) has been, for example, termed "a hypothetical pricing scheme that only an armchair economist could love." (J.Dilulio, WSJ, 10/2/96).

We, all former Chief Economists of the Antitrust Division of the U.S. Department of Justice, disagree, and would like to declare our support for both the principles behind TELRIC and the feasibility of implementing the TELRIC approach embraced in the FCC's order. We believe that forward-looking costs form the appropriate basis for determining whether rates charged to new entrants by the incumbent carriers in local markets are fair, reasonable, and efficient. Such rates will promote cost-based competitive prices for telecommunications end-user services as well as competitive vitality, innovation, and efficient investments in the network.

Prices based on forward-looking costs give the right signals to both producers and consumers to ensure the efficient use of resources. This has long been recognized by professional economists and has been an informing principle of antitrust and regulatory policy. With the massive changes underway in telecommunications, it is particularly important that sound economic principles underlie the pricing policies established by the FCC and the state commissions. The TELRIC standards established by the FCC provide the foundation for economically rational pricing regulations during these years of dynamic change and thereafter, and help to assure that investments and innovations that are implemented are efficient rather than attempts to exploit pricing anomalies.

As we move to a competitive market in the provision of local services, it is very important that unbundled element prices adhere closely to forward-looking economic cost. Any desired subsidies, such as those for universal services, should be implemented directly with competitive neutrality through taxes and subsidies that are truly transparent, as required by the Act, and not hidden in telephone prices in ways that undermine competition.

The incumbent local carriers complain that if the prices for unbundled elements and interconnections are based on TELRIC, they will be unable to recover full costs and thus unable to make new investments. The opposite is true. The main goal of TELRIC is to assure that they recover full costs, including the cost of capital, on a forward-looking basis. For unbundled elements whose forward-looking costs exceed their historical costs, TELRIC-based pricing will preserve the incumbent's incentive to invest and innovate. And, where historical costs exceed forward-looking costs, TELRIC-based pricing will still preserve those incentives, whereas the use of historical or embedded costs could result in two inefficiencies tending to sustain local monopolies, even those with outmoded equipment: First, competing providers might have to pay more than a competitive price for necessary inputs, and second, they might have to pay more than the incumbent local exchange carriers implicitly pay for these same inputs. The point of basing prices on TELRIC is to avoid these harms, and to promote competitive efficiency. If individual state commissions do decide to allow incumbent local carriers to recover more than their forward-looking economic costs, including a competitive return on capital, any such recovery should be done through a mechanism that is both competitively neutral and transparent to consumers.

The TELRIC standard will promote, not impede, cooperation between the incumbent carriers and the new entrants. The incumbent local exchange carriers have every incentive to impede entry, and in particular should be expected to resist based on forward-looking costs. By providing an objective standard for those cost-based rates, TELRIC causes the negotiation process to begin at a point it might not otherwise reach.

The Commission's original decision was correct in its adherence to these principles. These issues are complex, and it is no surprise that there is confusion and struggle over implementation of this momentous revolution in telephone regulation. We urge you to stand by the Commission's original decision, and remind you that there is a considerable body of intellectual capital behind that decision, plus a large number of well-informed individuals committed to help you defend it. Most importantly, in our view, the Commission's decision is fully consistent with the primary objectives of the 1996 Telecom Act.

Sincerely yours,

Bruce Owen. Director, Economic Policy Office, Antitrust Division, 1979-81. Currently President, Economists Incorporated and Visiting Professor of Economics, Stanford in Washington.**

Lawrence J. White. Director, Economic Policy Office, Antitrust Division, 1982-83. Currently Arthur E. Imperatore Professor of Economics at the Stern School of Business, New York University.*

Frederick R. Warren-Boulton. Director, Economic Policy Office and Deputy Assistant Attorney General for Economic Analysis, Antitrust Division, 1983-89. Currently Principal, MiCRA: Microeconomics Consulting and Research Associates, Washington D.C.*

Bobby Willig. Deputy Assistant Attorney General for Economic Analysis, Antitrust Division 1989-1991. Currently Professor of Economics and Public Affairs, Princeton University.**

Janusz A. Ordover. Deputy Assistant Attorney General for Economic Analysis, Antitrust Division 1991 -1992. Currently Professor of Economics, New York University.*

* Has consulted for interexchange carriers.
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